

Message Text

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PASS TREASURY FOR SYVRUD

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SUBJ: MEDIUM-TERM OUTLOOK

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1. SUMMARY: GOJ IS MOST ANXIOUS TO AVOID A "GO-STOP" POLICY DURING RECOVERY FROM CURRENT SEVERE RECESSION. DESPITE RESTIVENESS OF BIG BUSINESS FOR NEW ORDERS AND BETTER PROFITS, GOJ SHOWS CONTINUED PATIENCE AND CAUTION IN INSTITUTING STRONG REFLATIONARY MEASURES, PREFERRING TO AWAIT NORMAL RECOVERY PROCESS OF REVIVED CONSUMER CONFIDENCE AND COMPLETION OF EXCESS INVENTORY ADJUSTMENT. THIS IS CONSISTENT WITH PREOCCUPATION BY GOJ WITH ACHIEVING FURTHER REDUCTIONS IN THE RATE OF INFLATION DURING NEXT TWO YEARS. IT, THEREFORE, APPEARS UNLIKELY TO FINATT THAT GOJ WILL ADOPT EXCESSIVE REFLATIONARY POLICIES FEARED IN REFTEL. MORE-

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OVER, FUKUDA WISHES TO ACHIEVE A "SOFT LANDING" ON A SLOWER BUT

SUSTAINABLE LONGER TERM GROWTH WHICH IS YET TO BE DECIDED UPON. THERE IS NO INDICATION WHATSOEVER THAT JAPAN IS WAITING FOR EXPORT-LED GROWTH EVEN THOUGH BUSINESSMEN MAY BE ACTIVELY SEEKING FOREIGN ORDERS IN VIEW OF LACKLUSTER DOMESTIC DEMAND. FOLLOWING IS FINATT REPLY TO TREASURY REQUEST IN REFTEL. END SUMMARY.

2. CYCLICAL SITUATION: THERE IS A GENERAL BELIEF HERE THAT RECESSION HAS NOW REACHED BOTTOM IN JAPAN. THE VERY PROVISIONAL FIRST QUARTER GNP STATISTICS (REPORTED TOKYO 7806) INDICATE A SMALL PICK-UP IN FINAL DOMESTIC DEMAND AS WELL AS FINAL DEMAND (I.E. GNP LESS INVENTORY INVESTMENT). THE DECLINE IN REAL GNP OF 0.7 PERCENT REPRESENTS THE HEAVY INVENTORY ADJUSTMENT THAT TOOK PLACE. THE INDEX OF INDUSTRIAL PRODUCTION HAS RECORDED INCREASES FOR THE PAST TWO SUCCESSIVE MONTHS AND FACTORY SHIPMENTS ALSO SUGGEST A SUSTAINED PICK-UP IN DEMAND THROUGH APRIL. WITH INDUSTRIAL PRODUCTION STILL DECLINING IN THE U.S., ALBEIT AT SLOWER RATES, AND REMAINING FLAT IN GERMANY, THERE ARE SOME ANALYSTS WHO CONSIDER THAT RECOVERY IN JAPAN MAY WELL BE LEADING THAT IN OTHER OECD COUNTRIES.

3. INITIAL RECOVERY PHASE: THERE IS STRONG BELIEF AMONG MOF, EPA AND BOJ OFFICIALS THAT NATURAL RECOVERY FORCES, ALONG WITH GOJ MEASURES ALREADY ADOPTED, WILL ACCELERATE PACE OF RECOVERY IN LATE SUMMER. THESE CONFORM TO JAPANESE VIEWS PRESENTED AT OECD SHORT-TERM FORECASTERS' MEETING (REPORTED OECD PARIS 15138) OF REAL GNP INCREASE AT SEASONALLY ADJUSTED ANNUAL RATE OF 7 PERCENT IN SECOND HALF (OVER FIRST HALF) AND 7-1/2 PERCENT IN FIRST HALF 1976. SOME OFFICIALS CONCEDE THAT IT WOULD NOT BE INAPPROPRIATE FOR GOJ TO ADOPT ADDITIONAL REFLATIONARY MEASURES IN THE EVENT THAT RECOVERY PACE WAS SUBSTANTIALLY MORE SLUGGISH. THEY ALSO WARN THAT SUCH RECOVERY RATES ARE NOT SUSTAINABLE AFTER MID-1976 WITHOUT CREATING RENEWED INVESTMENT BOOM (ULTIMATELY LEADING TO ANOTHER STOP-GO POLICY) OR DISRUPTING OBJECTIVES OF PRICE STABILITY.

4. MEDIUM-TERM PRICE POLICIES: JAPAN'S STRUGGLE TO CONTROL ITS RAPID INFLATION DURING THE PAST YEAR HAS RESULTED IN AN ALMOST EXCLUSIVE FOCUS ON SHORT-TERM GOALS IN DETERMINING GOJ ECONOMIC POLICIES. AS SOON AS PRIME MINISTER MIKI'S GOAL OF LIMITING THE YEAR-TO-YEAR RISE IN CONSUMER PRICES TO 15 PERCENT BY MARCH LIMITED OFFICIAL USE

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1975 WAS ACHIEVED, A NEW GOAL OF HOLDING THE YEAR-TO-YEAR RISE TO THE ONE-DIGIT LEVEL BY MARCH 1976 WAS ANNOUNCED. ALTHOUGH THERE HAS BEEN MENTION OF A LONGER TERM AIM OF GETTING THE ANNUAL INCREASE DOWN TO 7 PERCENT DURING THE NEXT YEAR BEGINNING APRIL 1976, NO RELATION HAS BEEN DRAWN BY ANY OFFICIAL BETWEEN THAT GOAL AND DEPUTY PM FUKUDA'S STATEMENT THAT IN THE LONG RUN AN INFLATION OF 4 TO 5 PERCENT PER YEAR WOULD BE AN ACCEPTABLE RATE. THE IMPORTANT CONSIDERATION FOR JAPAN'S OVER-

ALL ECONOMIC POLICY IN THE MEDIUM TERM IS THE IMPACT OF INFLATION UPON DOMESTIC GROWTH OBJECTIVES. WHAT WOULD FORCE GOJ TO RETURN TO A STRONG RESTRAINT POLICY IS NOT THE PERSISTENCE OF INFLATION BUT A RESURGENCE TO A MORE RAPID RATE. THE DESIRE TO ACHIEVE A MONOTONIC DECLINE IN THE ANNUAL RATE OF INFLATION CONTRIBUTES HEAVILY TO THE CURRENT GOJ MOOD OF CAUTION REGARDING MOVES TO STIMULATE ECONOMIC RECOVERY AND TO CHOOSE A SUSTAINABLE MEDIUM-TERM GROWTH RATE. THE GOAL OF SUCH A MONOTONIC DECLINE WILL PROBABLY CONTINUE TO EXERT A STRONG RESTRAINING INFLUENCE UPON ECONOMIC POLICY AS LONG AS REAL RATE OF GROWTH REMAINS ABOVE AN ACCEPTABLE MINIMUM RATE OF PERHAPS 4 PERCENT PER YEAR.

5. ECONOMIC PLANNING POLICIES: MEDIUM AND LONG-TERM PLANNING HAS PLAYED AN IMPORTANT ROLE IN GUIDING GOJ ECONOMIC POLICY SINCE THE MID-1950'S. UNFORTUNATELY, THE MOST RECENT 5-YEAR PLAN WAS MADE QUICKLY OBSOLETE AS THE RESULT OF A STRONG RECOVERY STIMULUS IN 1972-1973 WHICH CREATED EXCESS DEMAND, RAPID INFLATION AND REQUIRED ANOTHER STOP-GO POLICY. DISCUSSIONS ARE ALREADY UNDER WAY FOR PREPARING THE NEXT PLAN FOR THE 1976-1981 PERIOD. TENTATIVE CONCLUSION HAS BEEN REACHED THAT CONSTRAINTS ON THE NATION'S POTENTIAL GNP GROWTH SHOULD BE (1) INELASTIC AND UNCERTAIN SUPPLIES OF RAW MATERIALS (ESPECIALLY ENERGY), (2) SLOWER GROWTH OF LABOR SUPPLY, AND (3) LIMITED AVAILABILITY OF INDUSTRIAL SITES. IT IS BELIEVED THAT THESE CONSTRAINTS WILL LIMIT THE POTENTIAL REAL ECONOMIC GROWTH RATE TO NO MORE THAN PERHAPS 6 PERCENT PER YEAR (IN CONTRAST TO AN AVERAGE ANNUAL GROWTH RATE OF OVER 10 PERCENT IN THE 1960'S). EPA OFFICIALS HOPE THAT THE PLAN, WHICH WILL NOT BE COMPLETED UNTIL 1976, CAN BE STRUCTURED IN SUCH A WAY AS TO BE A CONSIDERABLY MORE USEFUL TOOL IN MAKING SHORT-TERM ECONOMIC POLICIES BY THE GOVERNMENT. ONE OF THE MAIN OBJECTIVES IS TO ENSURE THAT ADEQUATE EXCESS CAPACITY IS AVAILABLE TO PREVENT THE KIND OF INVESTMENT BOOMS AND PERLIMITED OFFICIAL USE

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IODIC RECESSIONS THAT HAVE BEEN SO TYPICAL OF JAPAN'S POST-WAR ECONOMY.

6. FINATT ASSESSMENT: JAPAN'S GROWTH RATE DURING THE NEXT TWO TO THREE YEARS IS LIKELY TO BE SUBSTANTIALLY SLOWER THAN IN THE PREVIOUS DECADE. THE CYCLICAL PHASING WILL APPARENTLY COINCIDE WITH OTHER MAJOR OECD COUNTRIES. RECOVERY NOW UNDER WAY WILL BE THROUGH REVIVAL OF DOMESTIC DEMAND. IN THE FUTURE THERE IS A STRONG DESIRE TO OPERATE THE ECONOMY MORE FLEXIBLY SO AS TO AVOID GENERATING EXCESS DEMAND AND INFLATION WHILE ASSURING THAT A WIDE VARIETY OF DOMESTIC AND SOCIAL OBJECTIVES ARE ALSO ACHIEVED. THERE APPEARS TO BE NO DESIRE FOR AN EXPORT-LED RECOVERY. OFFICIALS ARE MORE SENSITIVE THAN IN THE PAST ABOUT AN EXCESSIVELY STRONG TRADE AND CURRENT ACCOUNT POSITION. THE NEW MEDIUM-TERM PLAN HAS IMPLICATIONS FOR OTHER COUNTRIES BUT IN

SETTING FUTURE POLICIES OFFICIALS APPARENTLY HOPE TO AVOID
THE KIND OF INTERNATIONAL ECONOMIC FRICTIONS THAT HAVE PLAGUED
JAPAN IN THE PAST.
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